

Foreign Debt: Forgiveness and Repudiation

By Enrique Carrasco, Charles McClellan & Jane Ro

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This section addresses two distinct approaches to debt relief for sovereign nations: debt forgiveness by creditors and debt repudiation by debtors. Our discussion of debt forgiveness begins by exploring the sources of foreign debt and the controversy surrounding debt relief. We outline the development of the popular debt-relief movement and describe the programs that multilateral lenders, such as the World Bank and the International Monetary Fund (IMF), have implemented to provide debt relief to the poorest countries. We then address the criticisms of these programs and creditors' continued efforts to provide appropriate levels of relief to heavily indebted nations.

Our discussion of debt repudiation traces the historical development of the repudiation doctrine. The doctrine espouses the complete repudiation of certain types of onerous debts—known as “odious” and “illegitimate debt.” We define these categories and provide real-world examples of each. We then address the practical challenges of implementing the repudiation doctrine and explore alternative approaches that have been advanced for providing poor countries with relief from its onerous debts.

Debt relief is a topic that has obtained a significant place on the agenda of modern global issues, and the debate over the goals and the means designed to reach those goals continues to be hotly contested. As you read through this chapter, ask yourself where you stand on these issues.

A. Understanding Debt Forgiveness: What It Means, Why It Is Important, Where the Debt Comes From, and Whether Debt Forgiveness Is a Good Idea

1. Debt Forgiveness—a Creditor's Act of Excusing a Borrower's Repayment of an Existing Obligation—Is Important for Poor Countries Struggling to Meet Their Welfare Needs.

Debt forgiveness, commonly referred to as “debt relief,” is the act of excusing heavily indebted developing countries from all or part of their “unsustainable” debts. The World Bank and IMF consider a country's debt unsustainable if either 1) the size of the country's external debt exceeds the value of its export by a ratio of 150%, or 2) the ratio of the country's debt-to-government-revenues ratio is above 250%. Simply put, these ratios are

indicators of a debtor-country's inability to repay its debts without exposing it to excessive hardship, both social and economic. For instance, countries such as Uganda spend an average of \$3 per person on health care while spending \$15 per person on debt service. Liberia, one of the world's poorest countries, has a total external debt of \$3.7 billion and can only afford to allocate \$7 million of its \$120 million annual budget to fight the HIV/AIDS epidemic, which has infected almost 8% of the country's population. Many of these poor countries believe that their welfare and survival are contingent on the forgiveness of their heavy debt burdens. Thus, it is important to understand the concept of debt forgiveness, and we will start by exploring where this debt comes from and what makes it unsustainable.

2. Global Economic Conditions and Domestic Strife in the 1970s and 1980s Caused Debt Burdens in Poor Countries to Reach Unsustainable Levels.

Many heavily indebted poor countries accumulated large debts from floating-interest-rate loans their governments took out in the 1960s and 1970s. Considerable and unexpected spikes in oil prices and interest rates in the 1970s and 1980s, coupled with a sharp decline in commodity prices, devastated the fragile economies of many developing countries, making repayment of foreign debt extremely burdensome, if not impossible. This forced many poor nations to assume new debt to pay off existing debt. As these countries became more dependent on loans to survive these external circumstances, domestic crises, such as civil wars and natural disasters, also added to the debt growth. To make matters worse, poor management of the loan funds often led to investment in unsuccessful public projects that generated little or no long-term social or economic benefit.

As a result of these events, debtor countries have been unable to pay off their debts, which have grown to unmanageable sizes. Many of these countries struggle to repay debts that are larger today than the amount originally borrowed as unpaid interest payments continue to accrue. To illustrate, as of 2005, Nigeria still owed approximately \$34 billion on an original loan of only \$17 billion. On top of this, Nigeria had made payments on this loan totaling \$18 billion. Altogether, developing country debt doubled from \$500 billion to \$1 trillion between 1980 and 1985 and doubled again between 1985 and 2000.

a. Distinctions between bilateral and multilateral sources of debt and legitimate and illegitimate uses of debt have created varied approaches to debt relief.

The debt of poor countries seeking debt relief can be categorized in two ways: by the type of lender or by the use of the loan proceeds. First, sovereign debt can be subdivided

into “internal” and “external” debt based on the type of lender. Internal debt is money that a country’s government owes to creditors who are also citizens of the country. Each country’s domestic laws govern internal debt, and it is not a factor in international debt-forgiveness programs. External debt comes from two main sources. The first source is “bilateral debt,” which is money owed by one government to another. Oftentimes, the lenders, or creditor countries, are developed nations such as the United States. Forgiveness of bilateral debt is accomplished largely through the “Paris Club,” a committee formed by the major creditor governments to address the problems that debtor-countries had with debt repayment. The Paris Club offers assistance to struggling debtor-countries by rescheduling debt repayments and forgiving portions of the debt. To date, the Paris Club has cancelled approximately \$60 billion of bilateral debt. The other source of external debt is “multilateral debt,” which is money owed to international financial institutions, such as the IMF and World Bank. This section primarily discusses multilateral debt relief.

Second, sovereign debt can also be classified by the types of projects and activities it finances. At a broad conceptual level, the uses of loan proceeds can be categorized as either “legitimate” or “illegitimate.” This dichotomy is best understood by the way scholars have defined illegitimate debt—money borrowed, typically by corrupt governments, under oppressive terms or for nefarious or ill-advised purposes that do not benefit the people. This includes debts incurred by dictators to benefit the ruling class. It also includes debts arising from failed or never-completed projects or any other applications that would not benefit the people of the developing nation. Many proponents of debt relief advocate the forgiveness of all poor-country debt, regardless of whether the loans were legitimate or illegitimate. Nevertheless, the distinction is important because there are several unique legal and moral justifications for providing debtor nations relief from illegitimate debts; these are outlined in the second half of this section.

3. Supporters of Debt Forgiveness Underscore the Welfare Needs of Impoverished Nations; Opponents Highlight the Unintended Consequences and Limited Impact of Debt Forgiveness.

Whatever their classification, it is clear that many poor nations labor under extraordinary debt burdens. It is less clear, however, whether, or to what degree, creditors should forgive the debt of developing countries. Supporters of debt forgiveness make a variety of moral arguments for the necessity of debt relief. Some of these reasons have already been discussed, such as the contention that certain debts are illegitimate and, perhaps the strongest argument, that demanding repayment ignores the needs of the people in developing nations by compromising the country’s ability to provide basic necessities. For

example, in 2003 Senegal used one-third of its revenues to service foreign debt and, like many African countries, is obligated to spend more towards debt repayment than on healthcare. Meanwhile, HIV/AIDS and other treatable diseases are an epidemic that continues to plague Africa. To repay their debts, these developing nations channel money away from projects aimed at reducing poverty and improving healthcare, education, life expectancy, and other social conditions; this inevitably contributes to and perpetuates the impoverished conditions under which these nations suffer.

Nevertheless, debt relief has been the subject of much criticism. Some critics view debt relief as counter-productive. For example, many object to the criteria used to determine which governments qualify for debt relief. Some fear that debt forgiveness perpetuates corrupt regimes in the same manner as illegitimate debt because it frees up government funds without any guarantee that the government will apply them to legitimate social or development programs. Another fear, referred to as the “moral hazard,” is that countries relieved of their debts will engage in reckless over-borrowing with the expectation that, once their debts reach unsustainable levels, international creditors will forgive them again.

Other critics contend that debt forgiveness is insufficient to remedy the economic problems that poor countries face. Without effective political and economic reforms, debt relief cannot provide long-term economic stability. For this reason, many creditors are skeptical of debt-relief advocates who tout debt forgiveness as the magical solution to poverty in developing nations.

B. The Debt Forgiveness Movement Takes Shape: The Path to Debt Forgiveness Initiatives through Grassroots Activism and Multilateral Creditor Action

1. Debt Relief Becomes a Public Issue: JUBILEE 2000 and other NGOs Press for Debt Forgiveness.

By the mid-1990s, proponents of debt relief were raising global awareness of the unsustainable debt problem. A wide coalition of development-focused non-governmental organizations (NGOs), Christian organizations, churches, and advocacy groups began a mass movement to pressure governments and institutions to solve the issue of debt in the Third World. One such movement, which began in Britain, solidified into an international-membership group called the “Jubilee 2000 Coalition.” Jubilee 2000 was an international-coalition movement in over 40 countries, including the United States. The group called for the cancellation of all unsustainable Third World debt by the year 2000. The movement attracted support from celebrities such as Bono of U2, Muhammad Ali, and Bob Geldof.

Jubilee 2000 staged demonstrations at the 1998 G-8 meeting in Birmingham, England. The G-8 refers to the eight countries (U.S., U.K., Canada, Japan, Germany, France, Italy, and Russia) that represent a majority of the world's economy. The group holds regular summits to discuss various global issues. At the Birmingham meeting, which, among other things, focused on achieving sustainable economic growth in the context of environmental protection and good governance, 70,000 demonstrators participated in a peaceful protest in an effort to put debt relief on the agenda of Western governments. The protestors made headlines around the world for their demonstrations and activities aimed at increasing awareness, such as forming a human chain around Birmingham City Centre, passing out petitions, and holding informative workshops. The protestors caught the attention of Prime Minister Tony Blair, who met with the directors of Jubilee 2000 to discuss the issue of heavy debt in poor countries. Subsequently, the Prime Minister publicly expressed his personal support for, and dedication to, debt forgiveness. Other notable successes that resulted, at least in part, from Jubilee 2000 pressure, included a promise from the United States during the G-7 (G-8 financial ministers, excluding Russia) meeting in Cologne, Germany in 1999 to cancel 100% of the debt that qualifying countries owed the U.S. Jubilee also lobbied the U.S. Congress to make good on this promise. Congress responded to the growing pressure to address debt relief issues in 2000 by committing \$769 million to bilateral and multilateral debt relief. In less than a decade, Jubilee 2000 succeeded in changing the thinking and policy on unsustainable debt on a global level.

2. Responding to the Issue of Third World Debt: The World Bank and IMF Implement the Heavily Indebted Poor Countries Initiative (HIPC) to Provide Debt Relief to Impoverished Nations.

Jubilee 2000 and other early proponents of debt relief scored one of their first victories in 1996 when the World Bank and IMF responded to the growing pressure for debt forgiveness by launching a program called the Heavily Indebted Poor Countries initiative (HIPC). HIPC aimed to reduce the external debt of poor countries and help them to achieve debt sustainability. In general, sovereign debt is sustainable when a borrowing nation's cost to make its debt payments is a fixed or declining proportion of its GDP. When debt payments consume an increasing share of the nation's GDP, the debt is considered unsustainable; unsustainable debt threatens the nation's economy as proportionately fewer funds are available each year to alleviate poverty and other social ills and to increase productivity. Prior to HIPC, borrowing nations could seek relief from their unsustainable debts only through bilateral negotiations with individual creditors or groups of creditors, such as the Paris Club; historically, bilateral negotiations led only to relief in

the form of rescheduled debt, with the expectation that the country would repay the full amount at a later date. Until 1996, when the World Bank and IMF introduced HIPC, there was no forum for debt relief from multilateral lenders or a forum to bring together bilateral and multilateral lenders to provide comprehensive debt-relief solutions. What follows is a discussion of how HIPC works, its criticisms, and the changes those criticisms have inspired.

a. HIPC: a six-year program for reducing debt to sustainable levels and for implementing structural reforms intended to promote long-term stability.

To receive debt relief under HIPC, a country must first meet HIPC's threshold requirements. At HIPC's inception in 1996, the primary threshold requirement was that the country's debt remains at unsustainable levels despite full application of traditional, bilateral debt relief. At the time, HIPC considered debt unsustainable when the ratio of debt-to-exports exceeded 200-250% or when the ratio of debt-to-government revenues exceeded 280%.

The World Bank and IMF conceived HIPC as a six-year program, split into two three-year phases, designed to generate a track record of good fiscal and economic performance. During Phase I, the country would work with the IMF to implement an enhanced structural adjustment facility (ESAF). The ESAF originally provided concessional loans to poor nations and required countries to comply with a broad range of detailed reforms and conditions, such as privatization of state industries or curtailment of domestic spending. The conclusion of Phase I was termed the "decision point;" it was then that the World Bank and IMF would review the nation's debt burdens and determine how much debt forgiveness they would provide to enable the nation to maintain sustainable debt levels in the future. Phase II required continued implementation of the ESAF and culminated in the "completion point," where creditors would forgive the country's debts in the amount they promised at the decision point.

b. Critics broadly attacked HIPC for being too limited, too slow, and counter to the interests of debtor nations.

Critics soon began to attack HIPC's scope and its structure. First, they criticized HIPC's definition of debt sustainability, arguing that the debt-to-export and debt-to-government-revenues criteria were arbitrary and too restrictive. As evidence, critics highlighted that, by 1999, only four countries had received any debt relief under HIPC. Second, the six-year program was too long and too inflexible to meet the individual needs of

debtor nations. Third, the IMF and the World Bank did not cancel any debt until the completion point, leaving countries under the burden of their debt payments while they struggled to institute structural reforms. Fourth, the ESAF conditions often undermined poverty-reduction efforts. For example, privatization of utilities tended to raise the cost of services beyond the citizens' ability to pay. Finally, critics attacked HIPC as a program designed by creditors to protect creditor interests, leaving countries with unsustainable debt burdens even upon reaching the decision point.

c. HIPC addressed its shortcomings by expanding its definition of unsustainable debts, making greater relief available to more countries, and by making relief available sooner.

Since 1996, the IMF has modified HIPC in several ways, often in response to the shortcomings its critics have highlighted. The IMF first restructured HIPC in 1999. These revisions modified HIPC's threshold requirements. Today, HIPC defines three minimum requirements for participation in the program. First, as before, a country must show its debt is unsustainable; however, the targets for determining sustainability decreased to a debt-to-export ratio of 150% and a debt-to-government-revenues ratio of 250%. Second, the country must be sufficiently poor to qualify for loans from the World Bank's International Development Association or the IMF's Poverty Reduction and Growth Facility (PRGF, the successor to ESAF), which provide long-term, interest-free loans to the world's poorest nations. Lastly, the country must establish a track record of reforms to help prevent future debt crises.

In addition to the modified threshold requirements, the 1999 revisions introduced several other changes. First, the six-year structure was abandoned and replaced by a "floating completion point" that allows countries to progress towards completion in less than six years. Second, the revised HIPC allows for interim debt relief so that countries begin to see partial relief before reaching the completion point. Third, the PRGF heavily modified ESAF by curtailing the number and detail of IMF conditions and by encouraging greater input from the local community into the program's design.

One of PRGF's goals is to ensure that impoverished nations re-channel the government funds freed from debt repayment into poverty-reduction programs. To that end, each country's PRGF program is modeled around a Poverty Reduction Strategy Paper (PRSP). PRSPs describe the macroeconomic, structural, and social programs that a country will follow to promote economic growth and reduce poverty. A broad range of government, NGO, and civil-society groups must participate in the development of the PRSP to ensure

the plan has local support. Under the revised HIPC, a country reaches the decision point once it has demonstrated progress in following its PSRP. The country then reaches its completion point once it has implemented and followed its PRSP for at least one year and has demonstrated macroeconomic stability.

In 2001, the IMF introduced another tool to increase HIPC's effectiveness. Under the new practice of "topping up," countries that unexpectedly suffer economic setbacks after the decision point due to external factors, such as rising interest rates or falling commodity prices, are eligible for increased debt forgiveness above the decision-point level.

d. HIPC approved over \$35 billion in debt forgiveness for thirty countries in its first decade.

As of December 2006, twenty-one countries have reached the HIPC completion point. Nine additional countries have passed the decision point and are working toward completion. Ten other countries carry unsustainable debts according to HIPC standards, but they have yet to reach the decision point. So far, the IMF and World Bank have approved \$35 billion of HIPC debt relief. Five countries have received an additional \$1.6 billion in "topping up" assistance since 2001.

Notable HIPC success stories include Tanzania and Mozambique. Tanzania reduced its annual debt payment by \$170 million. The government used the savings to increase spending on education and to eliminate elementary school fees, leading to a 1.6 million-student surge in enrollment. Mozambique channeled its savings from HIPC debt-relief into a number of social programs: \$13.9 million for child vaccination programs; \$10 million to bring electricity to rural schools and hospitals and to rebuild infrastructure damaged by natural disasters; and \$3.2 million to build new elementary schools and promote the education of young girls.

e. Critics continue to attack HIPC for failing to provide debt relief to enough countries or in sufficient amounts to reach debt sustainability and for failing to address the underlying causes of unsustainable debt.

Despite HIPC's successes, many criticisms remain. Critics still insist it is too narrowly limited by arbitrary criteria and too slow to provide actual relief. In fact, critics contend that creditors have cancelled only 10% of the debt owed by poor nations. The revised HIPC also provokes new allegations of creditor arbitrariness because the IMF and World Bank now unilaterally determine whether a country has reached the decision or completion point without any concrete criteria or outside input.

The most alarming criticisms suggest that HIPC simply does not work. First, critics warn that successful completion of the HIPC program fails to reduce debt to sustainable levels, in part because HIPC premises the level of debt relief it will provide on unrealistically optimistic economic projections that ignore the historical, political, geographic, and economic realities in underdeveloped nations. Furthermore, even if a country succeeds in reducing its debts to sustainable levels, there is no guarantee it will avoid accumulating debts at unsustainable levels in the future. If the underlying causes of unsustainable debt, such as corrupt governments, poor project selection, or usurious lending, remain unremedied, then the country's debt burden could easily return to unsustainable levels despite HIPC relief. Moreover, HIPC relief might create a "moral hazard" for debtor nations—an incentive for poor countries to borrow recklessly in the future with the expectation that, if their debts again reached unsustainable levels, creditors would forgive them. The debtor nation's problems are compounded when private investors decline to invest in countries that fail to achieve long-term debt sustainability or economic stability despite HIPC assistance. Finally, there is no evidence that HIPC's attempt to link debt forgiveness to poverty-reduction efforts has had any success. In fact, three studies in 2005 found that debt relief had no effect on the growth rates (economic growth presumably leads to a reduction of poverty) of HIPC countries.

Uganda's experience underscores HIPC's limitations. Uganda successfully reached the completion point under the original HIPC criteria and again under the modified criteria when the IMF expanded its definition of unsustainable debts. Although HIPC relief is designed to reduce a nation's debt burden below the 150% debt-to-export ratio, Uganda's ratio has ballooned to over 300% within three years of its HIPC completion point—50% higher than its pre-HIPC ratio.

3. The United Nations' Millennium Development Goals for Reducing Poverty Inspired the Multilateral Debt Relief Initiative to Provide 100% Multilateral-Debt Forgiveness to Impoverished Nations.

In 2000, recognizing the need to assist impoverished nations more aggressively, UN member states adopted a series of progressive goals known as the Millennium Development Goals (MDGs). The MDGs aim to spur development by improving social and economic conditions in the world's poorest countries. The goals include halving poverty by 2015, reducing child-mortality rates, fighting disease epidemics such as AIDS, and developing a global partnership for development.

Progress towards reaching these goals has been slow, due in part to the low-income

countries' \$523 billion debt load that continues to divert funds from domestic reforms and social programs. To accelerate progress towards the MDGs, the G-7 Finance Ministers met in London in June 2005 (in preparation for the G-8 Gleneagles Summit in July) and reached an agreement to provide enough funds to the World Bank, the IMF, and the African Development Bank (ADB) to cancel an additional \$40-55 billion in debt owed by HIPC nations. This would allow impoverished countries to re-channel the resources saved from the forgiven debt to social programs for improving health and education and for alleviating poverty.

Backed by G-8 funding, the World Bank, the IMF, and the ADB each endorsed the Gleneagles plan and implemented the Multilateral Debt Relief Initiative (“MDRI”) to effectuate the debt cancellations. The MDRI supplements HIPC by providing each country that reaches the HIPC completion point 100% forgiveness of its multilateral debt. Countries that previously reached the decision point became eligible for full debt forgiveness once their lending agency confirmed that the countries had continued to maintain the reforms implemented during HIPC. Other countries that subsequently reach the completion point automatically receive full forgiveness of their multilateral debt under MDRI.

While the World Bank and ADB limit MDRI to countries that complete the HIPC program, the IMF's MDRI eligibility criteria are slightly more expansive so as to comply with the IMF's unique “uniform treatment” requirement. Instead of limiting eligibility to HIPC countries, any country with annual per capita income of \$380 or less qualifies for MDRI debt cancellation. The IMF adopted the \$380 threshold because it closely approximates the countries eligible for HIPC.

4. The Lack of Progress toward MDGs and the Slow Pace of Debt Forgiveness Continue to Attract Criticism.

Despite the efforts and renewed promises to accelerate progress towards reaching the MDGs, world leaders and scholars acknowledge that not enough has been accomplished. Many studies, such as the Millennium Project report under Jeffrey Sachs, Kofi Annan's report “In Larger Freedom,” and numerous studies done by NGOs in the context of the Global Call of Action against Poverty (GCAP), found that unless governments take radical steps to ensure that countries realize the MDGs by 2015, the effort would fail.

To highlight public discontent with the lack of progress towards the MDGs, the “Make Poverty History” campaign—a coalition of more than 540 British and Irish

charities, religious groups, and celebrities—organized large-scale public-awareness events. For example, they mobilized a march of 225,000 participants in Edinburgh on July 1, 2005, just before the G-8 Gleneagles Summit, which addressed a broad range of issues, including the global economy. The symbol of the campaign was a white wristband, and July 1 was dubbed the first international “White Band Day” to commemorate a worldwide day of action. On July 2, the famous Live 8 concerts took place to encourage activism and debate among the member countries and to increase political pressure on their leaders. Similar campaign efforts are ongoing in Canada and Norway.

In that backdrop, 154 heads of state and government and 900 ministers gathered at the United Nations on September 14-16, 2005, to evaluate the progress on the 2000 Millennium Declaration. NGOs, the media, many heads of government and ministers, including then U.N. Secretary-General Kofi Annan, expressed disappointment at the weak outcomes of the negotiations: “Let us be frank with each other, and with the peoples of the United Nations. We have not yet achieved the sweeping and fundamental reform that I and many others believe is required. Sharp differences, some of them substantive and legitimate, have played their part in preventing that.” Unfortunately, despite dissatisfaction with progress towards the MDGs, the summit fell short of its expectations.

Although hardly any new decisions emerged beyond a reaffirmation of the MDGs, the governments represented at the summit made a commitment to the adoption and implementation of comprehensive National Development Strategies, policy goals designed to make the MDGs a reality. However, it was not clear how the development strategies would be carried out. Thus, by the end of 2005, the questions still remained whether the governments would actually adopt National Development Strategies, whether the World Bank, IMF, and ADB would fully implement the debt cancellation of the most heavily indebted poor countries, as they pledged, and whether debt cancellations for the nineteen remaining HIPC countries, as well as other heavily indebted non-HIPC countries, would follow.

Since the 2005 meeting at the United Nations, successor organizations to Jubilee 2000, such as the Jubilee USA Network and the Jubilee Debt Coalition in the U.K., have continued to fight for debt relief from creditor nations and multilateral financial institutions. Recent campaigns include the “Drop the Debt” campaign to lobby the U.S. government to fight extreme poverty and meet the MDGs and the “Unfinished Agenda on International Debt.” The Unfinished Agenda encourages world leaders to expand the scope of the HIPC and MDRI debt forgiveness programs, to remove the conditions imposed on countries by

the HIPC program, to cancel all illegitimate debts, and to take other steps necessary to eliminate the debt of impoverished nations.

C. The Doctrine of Repudiation of Odious and Illegitimate Debts: What It Is, What It Would Accomplish, Practical Obstacles to Its Implementation, and Alternative Approaches for Eliminating Onerous Debts

While multilateral financial institutions, such as the World Bank and IMF, work to design and improve effective debt-forgiveness programs, some critics of foreign lending programs argue for a more aggressive approach: debtor repudiation of “odious” or “illegitimate” debts. While the origins of this approach are more than a century old, the doctrine lay dormant for three-quarters of a century before it reemerged in connection with Iraq’s regime change. The current discussion of this topic has raised several issues: What is odious debt? What are the doctrine’s objectives? How would the doctrine be implemented in practice? What are its shortcomings? We address each of these issues below.

1. The Doctrine of Odious Debts Begins as a Synthesis of the “War Debts” and “Hostile Debts” Doctrines That Governments Used to Justify Repudiation of Pre-existing Debts following a Regime Change.

By the turn of the Twentieth Century, governments had repudiated certain loans in the name of “war debts” and “hostile debts.” War debts are those incurred by a government to finance a war against a force that later takes power in the country. The idea, based on the actions of the British following their victory in the Boer War, is that a conquering power should not have to repay the debts of its opponents. The hostile-debt approach arose from the U.S. repudiation of Cuban debts owed to Spain following the Spanish-American War. In that case, the United States refused to repay the debt on three grounds: 1) the proceeds were used in a manner hostile to the interests of the people expected to repay—to repress the Cuban people, 2) the debts were not incurred with the consent of the people, and 3) the lenders should have known that repayment was limited to the life of the borrowing political regime.

In 1927, the scholar Alexander Sack grouped both approaches under a single term: “odious debt.” According to Sack, a debt was presumptively odious if it satisfied the following criteria: 1) it was contracted by a despotic regime, 2) it was not used in the general interests or for the needs of the population, and 3) the lender knew about the first two conditions. Debts identified as odious are null—as if they never happened—and the borrower does not have to repay them. Nevertheless, the doctrine of odious debts never caught on, and no state expressly repudiated its obligation to repay a loan for being odious.

a. Modern scholars expanded the doctrine’s scope to encompass all loans used for nefarious purposes, provided to dictatorial regimes, or that are otherwise illegitimate.

Sack’s original three-part definition applied in only very narrow circumstances following a regime change. Modern discourse, however, often defines odious debt more broadly as any debt incurred by an authoritarian ruler for personal or nefarious purposes or as any debt incurred by an odious regime. The shift from odious debts—where the focus is on the purpose and use of a single loan—to odious regimes—where the focus is on the borrower—dramatically expands the doctrine’s reach.

This expanded definition is, at least in part, practical. For example, it provides a more predictable standard for lenders. Once a regime has been identified as odious, all lending to the regime is done at the lender’s risk, whereas it is more difficult for the lender, at the time of the loan, to know the ultimate use of the funds it is providing. Another complicating factor for loan-by-loan analysis is the fungibility of money. That is, every dollar is the same, regardless of its source. In the context of odious debts, that means that a lender might provide a loan for a legitimate state project, such as the construction of a public hospital, but that funding has the side effect of freeing up the regime’s money from other sources for nefarious or personal uses, such as the construction of ornate, personal palaces.

Some advocates of debt cancellation, including Jubilee 2000, would extend the underlying concepts of odious debts further to authorize repudiation of all “illegitimate” debts. Illegitimate debts include odious debts, plus any debt that is not sanctioned by law; debt that is unfair, improper, or objectionable; or debt that infringes on public policy. This includes debts that have high interest rates, fuel corruption, fund failed or destructive projects, or that are linked to bad policy. Under such a broad definition, most—if not all—debts incurred by developing nations would be illegitimate.

b. Examples of odious and illegitimate debts in Africa, the Middle East, and Latin America illustrate the multi-billion dollar burdens that result from onerous lending practices.

Examples of odious and illegitimate debts exist throughout the world. Three examples of odious lending are Zaire/Congo, South Africa, and Iraq. Three examples of illegitimate lending are Tanzania, Nigeria, and Latin America.

In Zaire/Congo, an IMF appointee in the nation’s central bank reported in 1979 that Zaire had no chance of repaying its creditors. Despite this, western governments and the

IMF continued to pour billions of dollars in loans into the country, almost a decade after General Joseph Mobutu's corrupt government stopped making payments on its debts. This example underscores the critique that irresponsible lending is partly to blame for odious debts.

In South Africa, lenders ignored the apartheid regime's crimes against humanity, as labeled by the United Nations, and poured billions into the repressive government. By the end of apartheid, South Africa's successor government was saddled with a \$21 billion debt. Even after favorable debt restructuring, South Africa's present indebtedness is almost entirely attributable to its odious debts.

Iraq's regime change has been a catalyst for the resurrection of the odious debt doctrine. Over approximately 25 years of dictatorship, Saddam Hussein accumulated \$125 billion in unpaid debts. Much of that debt financed Hussein's tyrannical regime and its military to the detriment of the oppressed Iraqi people.

Tanzania and Nigeria are both recipients of illegitimate loans used to finance failed projects. Tanzania owes the World Bank over \$575 million for 26 failed agricultural projects. Nigeria owes more than \$5 billion in loans for projects that never started or failed.

Lending to Latin America in the 1970s and 1980s is an example of illegitimate usurious lending—that is, lending at exorbitant interest rates. As interest rates rose, lenders provided increasingly large loans that carried floating interest rates throughout Latin America, most of which went to paying interest on earlier loans. By 1981, \$45 billion of the \$61 billion in loans to Latin America returned immediately to creditors to cover past debt. In 1982, with interest rates up to 13% from 5% in 1970, Latin American countries were unable to pay the interest accumulating on their debts, much less pay down the principal. In August of that year, Mexico declared that it could no longer pay its foreign debt, triggering a decade-long debt crisis in the region. Despite the \$612 billion paid to service the debt in the 1980s and 1990s, the \$237 billion of Latin American debt in 1982 grew to \$660 billion in debt by 2001.

2. Repudiation of Odious Debts Achieves Two Purposes: It Eliminates Debtors' Obligations to Repay Past Onerous Debts, and It Discourages Lenders from Making Odious Loans in the Future.

The first objective of the odious-debt doctrine is to provide borrowing countries a “morning-after” remedy to relieve themselves of seemingly unjust burdens. It is a response

to society's moral outrage that citizens of a country are forced to repay loans governments obtain and subsequently use without their consent for nefarious purposes.

A second, preventative goal of the odious-debt doctrine is to stop lenders from making unjust loans in the first place. If successful, the doctrine would reduce onerous debt burdens on developing nations. It would also leave odious regimes without any source of financing, which would foster democratic forms of government. Less obvious benefits include a reduced risk to creditors of default, which would translate to lower interest rates for legitimate borrowers. While opponents of debt cancellation cite the borrower's moral hazard, forcing repayment of onerous loans at all costs creates a moral hazard for lenders—an incentive to continue indiscriminate lending policies to impoverished nations because the international community will eventually enforce repayment.

3. Practical Considerations Limit the Feasibility of the Repudiation Doctrine for Odious Debts: Which Definition of Odious Debts Will Apply, Who Will Decide Which Loans Are Odious, What Enforcement Mechanisms Will Be Necessary to Administer the Doctrine, and How Will the Doctrine Respond to Changed Circumstances.

One reason that the doctrine of repudiation of odious debts has not caught on is the difficulty of applying it in real-world situations. Practical application of the doctrine presents several questions.

First, how narrowly or broadly should the term odious be defined? How should the doctrine balance creditor and borrower interests? Should the definition be limited to authoritarian regimes? What about loan proceeds siphoned off by corruption or embezzlement in democratically-elected governments? Where is the line between legitimate democratic governments and mock democratic governments? What about bad regimes that inherit legitimate debt? Should the definition be broad enough to include not only bank loans and other traditional forms of debt, but also other categories of odious obligations, such as the sale of income-generating assets or long-term contracts for the exploitation of natural resources?

It seems that creditors would prefer a narrow definition and that borrowers would benefit most from a broad interpretation of the term. At the same time, the debtor nation's desire to repudiate its debts must be offset against its need for future financing—the broader the power to repudiate, the less willing creditors will be to provide financing.

Additionally, if the doctrine is going to provide any guidelines for lenders on future

loans, the criteria for odiousness must be sufficiently detailed; otherwise, changing and ambiguous standards will adversely impact well-meaning creditors.

Second, who should determine what loans—or regimes—are odious? Proponents have offered a number of suggestions, including the U.N. Security Council, the International Court of Justice (ICJ), the Dispute Settlement Body of the World Trade Organization, a neutral arbitration panel, or domestic courts in the creditor or borrower nation. Many feel that a new, independent, international body should be created to adjudicate odiousness. Others suggest that the appropriate forum depends on the nature of the creditor and the forum selection clauses in the loan documents. For example, the ICJ might be an appropriate forum when the lenders are states that mutually consent to ICJ jurisdiction. Alternatively, non-state creditors that cannot take their disputes to the ICJ, such as multilateral institutions or private commercial banks, might require debtor nations to consent to arbitration as the sole means for resolving disputes related to the debt.

Whatever body is chosen or created, additional issues arise: how to balance creditor/debtor representation and whether membership should rotate; how to ensure the body has relevant expertise; how to fund the body; and whether majority, supra-majority, or unanimity will be required to make determinations. Some suggest that the United States wields enough political and economic influence to initiate the process unilaterally, allowing its borrowers to cancel all debts it determines to be odious, and that other creditor nations will eventually follow until the odious-debt doctrine becomes an international norm. Finally, one proposal would invite NGOs to create and distribute a list of odious regimes that would put creditor nations on notice that they might be lending at their own risk.

Related to the question of who will enforce the doctrine is who will be allowed to initiate an action to declare a loan odious? The parties themselves? Any party, such as an NGO? The answer must be determined by balancing access to the adjudicative body with the need for order and control over the process.

Third, how will the doctrine be enforced? Some proposals focus on protecting debtor nations that choose to repudiate odious debts. For example, one proposed mechanism would require creditor nations to enact domestic legislation prohibiting the use of domestic law to seize assets or otherwise enforce judgments for the collection of odious debts. In addition, repudiation will only be effective if backed by a prohibition against the creditor from seeking recovery for unjust enrichment—a legal theory that otherwise would require the debtor nation to return the principal borrowed.

Other proposals aim to pressure debtor countries to pursue repudiation. Some nations hesitate to repudiate their debts because of stigmatization in the financial community and the inability to attract additional financing. One proposal to encourage debtors to repudiate would condition future aid from international agencies, such as the IMF or World Bank, on repudiation of all odious debts. Critics, however, point out that the law should not punish a debtor nation that chooses to honor its obligations.

Fourth, how would the doctrine respond to changed circumstances? What happens when good regimes become odious, or vice-versa? What happens when legitimate loans are later used for illegitimate purposes, or when they are used in part for legitimate projects, but in part for nefarious projects? Proponents aver that creditors can mitigate such concerns by careful contracting. For example, the loan documents could specify a legitimate purpose for all loan proceeds and bind the debtor to that purpose by warranty. Furthermore, the creditor could disburse the loan proceeds in installments. If the money is not allocated as promised in the loan agreement, future installments would be withheld and past installments would become payable immediately. Such contractual provisions would help demonstrate the creditor's efforts to avoid odious lending practices, strengthening their claim for repayment.

4. Obstacles to the Implementation of the Repudiation Doctrine Spark the Exploration of Alternative Approaches for Eliminating Odious Debts: Traditional Mechanisms for Bi-lateral Debt Forgiveness and the Extension of Domestic Legal Regimes to International Lending Practices.

Some of the shortcomings of the repudiation doctrine are evident from the previous discussion about implementing this doctrine in practice: it is difficult, if not impossible, to craft a definition of odious debt that can balance the interests of debtors and creditors and effectively target loans that are truly odious. Also, as mentioned earlier, this definitional ambiguity makes the doctrine less effective as a tool to prevent future odious loans because the criteria are not sufficiently defined to guide a lender's business decisions.

At the same time, the resurrection of the odious-debt discussion, even if impractical to implement, has prompted consideration of other doctrines that might achieve the same result. The first alternative is for the debtor nation simply to renegotiate the terms of the debt with its creditors. This may result in better borrowing terms or even partial debt forgiveness. This is what happened with the Iraqi debt—80% was forgiven by creditors, mitigating the need to resort to an ambiguous and still unaccepted doctrine that carries with it the stigma of backing out of one's obligations.

Additionally, many new proposals have been made that would permit borrowers to avoid repayment. One proposal from the IMF was to create a Sovereign Debt Restructuring Mechanism (SDRM). The SDRM essentially would have created a “sovereign bankruptcy” mechanism that would give states a new beginning, much the same as a corporation or an individual who files bankruptcy. Efforts to develop the SDRM stalled in 2003 when the U.S. Treasury publicly rejected the idea.

Another solution would apply domestic lending laws to creditors in the international arena. For instance, consumers in most developed nations enjoy statutory protection against various predatory lending practices; governments could extend consumer protection laws to control loans to foreign states. Alternatively, sovereign states can be treated under the law like giant corporations. In that case, the law of agency would apply, and an agent (government leader) cannot bind the principal (the state) to a contract that the agent does not have authority to execute. Therefore, under agency law, odious loans contracted by dictators without popular consent would be unenforceable.

Although no sovereign nation has tested the agency approach internationally, two U.S. states successfully invoked agency principles to avoid debt repayment in the Nineteenth Century. In the 1860s, the South Carolina Supreme Court declared more than \$1 million of state debt illegal because state agents contracted the debts without authority. In Mississippi in the 1830s, the state legislature repudiated the state bank’s sale of bonds because it sold them in violation of the state’s instructions to the bank’s agents. These examples suggest that the agency law approach might provide a workable protection for debtor governments against repayment of odious debts contracted by state agents without the consent of the general population.

Related to this agency law approach, debtor nations could also seek damages under the doctrine of knowingly assisting a breach of trust from creditors that issue odious loans. When a creditor knows that the debtor-nation’s agent (government leader) will use the debt for a purpose outside of the agent’s authority (not for the benefit of the people), the debtor-nation can sue the creditor for any harm it sustains from the transaction. While not strictly debt repudiation, holding the creditor liable for the debt would accomplish a similar result.

Finally, various principles of domestic contract law that judges use to redefine contract terms or invalidate private agreements can be extended to sovereign debt agreements. Applying legal doctrines such as fraud or piercing the corporate veil (a doctrine that allows creditors to recover from a shareholder who misuses corporate assets for his or

her own gain, the way a dictator might misuse a nation's loan proceeds) to sovereign debts could invalidate some loan agreements or permit the borrowing nation to avoid repayment.

The advantage of these alternate approaches to repudiating or modifying odious debts is that they build on legal infrastructures that are well-developed, offering greater predictability and consistency than the odious-debt doctrine.